ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author:	Ridley-Thomas	Analyst:	Gloria McConnell	Bill Number:	AB 1390
Related Bills:	None	Telephone:	845-4336	Introduced Date:	02/21/03
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Fuel-Efficient Vehicle Credit

SUMMARY

This bill would create a tax credit for taxpayers that purchase fuel-efficient vehicles.

PURPOSE OF THE BILL

According to the author's office, this bill is intended to provide taxpayers with an incentive to purchase fuel-efficient vehicles.

EFFECTIVE/OPERATIVE DATE

This bill is a tax levy. Thus, it would be effective immediately and apply to taxable years beginning on or after January 1, 2003, and before January 1, 2008.

POSITION

Pending.

Summary of Suggested Amendments

Department staff is available to assist with amendments to resolve the implementation and policy concerns discussed in this analysis.

ANALYSIS

FEDERAL/STATE LAW

Existing state and federal laws allow taxpayers various tax credits. However, neither state nor federal laws have a tax credit similar to the one proposed by this bill.

Current state and federal laws generally allow taxpayers engaged in a trade or business to deduct all expenses that are considered ordinary and necessary in conducting that trade or business. If expenditures are for the purchase of property that has a useful life in excess of one year, such as a fuel-efficient vehicle, then the cost is generally capitalized and recoverable over the useful life in the property in a form of depreciation deductions.

Board Position:			Department Director	Date
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THIS BILL

This bill would allow taxpayers that purchase fuel-efficient vehicles a tax credit equal to 20%, not to exceed $2,000, of the amount paid or incurred during the taxable year for the purchase of that vehicle.

"Fuel-efficient vehicle" would be defined as a qualified vehicle that achieves fuel efficiency that is at least 25% greater than the baseline miles per gallon usage, as calculated by the California Energy Commission, for vehicles in the same class as that vehicle.

This bill would allow any unused credit to be carried over until exhausted.

This credit would remain in effect until January 1, 2009, and as of that date would be repealed.

IMPLEMENTATION CONSIDERATIONS

Department staff has been in contact with staff of the California Energy Commission regarding the implementation and administration of this tax credit. Preliminary discussions indicate that the Energy Commission could post on its website a list of fuel-efficient vehicles that would be eligible for the credit. This posting would allow taxpayers, manufacturers, and dealers to know if a vehicle would qualify for the tax credit. The Energy Commission could also furnish Franchise Tax Board (FTB) with a list of the vehicles, if needed. With the continued assistance of the California Energy Commission, this tax credit could be implemented and administered by FTB without significant problems. Discussions between the department and commission staff will continue as the bill moves through the legislative process; if concerns are identified, amendments will be suggested.

Preliminary research indicates that records maintained by the Department of Motor Vehicle could be used by the taxpayer or FTB, as needed, to substantiate the purchase and cost of the vehicles.

It is noted that this bill does not limit the number of years for the carryover period. The department would be required to retain the carryover on the tax forms indefinitely because an unlimited credit carryover period is allowed. Recent credits have been enacted with no more than an eight-year carryover period since experience shows credits are typically used within that period of time.

OTHER STATES' INFORMATION

Florida, Illinois, Massachusetts, Michigan, Minnesota, and *New York* laws do not provide a credit comparable to the credit allowed by this bill. The laws of these states were reviewed because their tax laws are similar to California's income tax laws.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

The revenue loss from this bill could exceed a billion dollars annually given that the tax credit would apply to any purchase of fuel efficient vehicles, regardless of whether that same vehicle was new or used or purchased many times during a given year. In addition the vehicle could be purchased by nonresidents or apportioning corporations, as discussed under policy consideration.

If this bill were amended to resolve the policy considerations, then the revenue loss from this bill is estimated to be approximately $88 million annually for every 5% of auto sales in this state.

Revenue Discussion

The impact of this bill would depend upon the number of taxpayers purchasing fuel-efficient vehicles, the purchase cost of the vehicle, the number of vehicles purchased, and the average credit applied against tax liabilities.

For purposes of this analysis, the 2000 California Statistical Abstract reflecting vehicle records for 1999 was used. In addition, the following assumptions were used: (1) based on departmental data for corporate taxpayers and from the department's Personal Income Tax model, of the $2,000 maximum credit allowed by this bill, the average applied credit is estimated to be $1,450; and (2) assumed 10% of vehicle purchases would be for business use subject to a deductible business expense. However, because of rounding of numbers associated with determining the number of vehicles at issue and the amount of the applied tax credit, this rounding of numbers generally absorbs the relatively small loss attributable to the business expense deduction, and, therefore, this loss is not identified as being included in the calculation discussed below.

To arrive at the estimate that the revenue loss would exceed billion dollars annually, it was determined that 8 million vehicles less than five years old were registered in California. If 5% of these vehicles were purchased and qualify for the credit, and the applied credit is $1,450, the revenue loss for those California registered vehicles would be approximately $600 million (8 million x 5% x $1,450= $580,000,000). It is presumed that this approximate $600 million annual revenue loss for California would quickly grow to nearly a billion dollars, given that this bill provides an opportunity for abusive churning of the purchase of a fuel-efficient vehicle. This nearly billion dollar loss is then grown by losses of hundreds of million dollars attributable to vehicles registered out of state by non-resident taxpayers and apportioning corporations.

To arrive at the $88 million annual revenue loss, it was determined that 1.6 million vehicles are of the classes identified by this bill and registered for the first time in California. Of this total, it is assumed that 75% of these vehicles would be newly purchased vehicles (1.2 million). If 5% of these vehicles qualify for the credit, of which $1,450 is the applied credit, the annual revenue loss would be approximately $88 million (1.2 million x 5% x $1450= $87,000,000). Likewise, if these vehicles qualifying for the credit were 10% of total sales, the loss would be $177 million; 15% of the total sales would be $265 million.

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

POLICY CONCERNS

Conflicting tax policies come into play whenever a credit is provided for an item that is already currently deductible as a business expense or is depreciable. Providing both a credit and allowing the full amount to be deducted would have the effect of providing a double benefit for that item. On the other hand, making an adjustment to reduce basis in order to eliminate the double benefit creates a difference between state and federal taxable income, which is contrary to the state's general federal conformity policy. In the case of a one-time business expense deduction, the reduction of that expense by the amount of the credit would not create an ongoing depreciation difference.

This bill allows the credit in the taxable year in which the fuel-efficient vehicle is purchased. It is possible that a taxpayer could unduly benefit from this tax credit by purchasing the fuel-efficient vehicle, claiming the credit, and immediately selling the vehicle. If this bill were to require that the vehicle be registered to the taxpayer in California for a specified period (e.g., for at least the taxable year in which the purchase occurred and perhaps the following taxable year or years) subject to adding all or part of the credit amount back to the tax liability (recapture), this potential problem would be avoided.

The above recapture provision could also help reduce the following considerations.

- Churning the purchase --This tax credit is based on a “purchase” of a fuel-efficient vehicle, which would apply to original purchases, as well as re-sales. Therefore, family members, friends or other groups could resell the same vehicle between themselves many times, over a period of years, and unduly benefit from the credit. By requiring that the vehicles be registered by the taxpayer for a specific period of time as discussed above, the significance of this consideration would be reduced.

- Qualified vehicles outside California --This tax credit would be available for the purchase of fuel-efficient vehicles without regard to where the vehicle is registered and primarily driven. As such, it would be available to nonresidents and apportioning corporations. In addition, in the case of companies that purchase vehicles to be leased, the credit would be available to the company regardless of when or what state that lease is in effect. By requiring the taxpayer to have the vehicle registered in California over a specified period as discussed above, the significance of this consideration would be reduced.

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